Supreme Court, U.S.
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No. 91-1154

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

STANDARD FRUIT COMPANY,
STANDARD FRUIT AND STEAMSHIP COMPANY,
and CASTLE & COOKE, INC.,
Petitioners,

v.

REPUBLIC OF NICARAGUA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

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COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Was the Court of Appeals correct in reviewing the arbitration agreement *de novo* to determine its validity and scope?

2. Did the Court of Appeals correctly apply *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), in ruling that the District Court should have left it to the Arbitrators to adjudicate the question whether the Memorandum of Intent signed by the parties was a binding contract?

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RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

Respondent, the Republic of Nicaragua (hereafter "Nicaragua"), urges the Court to deny the petition for writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit. As fully set forth below, the Court of Appeals correctly applied *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1969), and correctly reviewed questions relating to arbitrability *de novo*. Its decision presents no issues appropriate for review by this Court.

STATEMENT OF THE CASE

A. Proceedings Below

Nicaragua filed this suit against Petitioners in the U.S. District Court for the Northern District of California on October 21, 1986. Nicaragua alleged that when the parties signed a "Memorandum of Intent" in January 1981, they entered into a binding contract which required, *inter alia*, that Petitioners purchase all export quality Nicaraguan bananas for five years, and that Petitioners breached this contract when they terminated their Nicaraguan banana operations 22 months later. Nicaragua further alleged that, in Paragraph IV of the Memorandum, the parties entered into a written agreement requiring that all disputes arising under the Memorandum be submitted to arbitration in London. Thus, in Count I of its Amended Complaint, Nicaragua sought an order referring its dispute with Petitioners to international arbitration in accordance with Paragraph IV of the Memorandum. In the alternative, in the remaining counts, Nicaragua asserted the merits of its claims against Petitioners. (Count II, for example, alleges breach of contract.)

After the Petitioners' filing of an Answer and Counterclaims, Nicaragua moved, pursuant to the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, for an order referring the entire case to arbitration in London. Petitioners moved to dismiss Count II of the Amended Complaint on the ground that the Memorandum was an unenforceable agreement to agree, and on the further ground, with respect to defendant Standard Fruit Company, that it was not a signatory to the Memorandum.

The District Court (Honorable John P. Vukasin) heard both motions together. CR 97.[1] Nicaragua argued that the question whether the Memorandum constituted a binding contract was one for the arbitrators, not the court, to resolve. Judge Vukasin disagreed. *Id.* at 37-39, 50. He therefore set a preliminary hearing to determine whether a binding contract existed between the parties[2] and, if so, whether the arbitration clause in the Memorandum required arbitration of the disputes presented. *Id.* at 50. He concluded that Petitioners' motion to dismiss should be treated as a summary judgment motion under Rule 56, and deferred ruling until after the hearing. *Id.* at 8-9.

After the hearing, Judge Vukasin adopted the proposed findings of fact and conclusions of law submitted by Petitioners, virtually word for word.[3] He denied Nicaragua's motion to compel arbitration (and dismissed Count I) on the ground that the evidence did not demonstrate that the Memorandum was a contract, or, alternatively, because Nicaragua did not establish by a preponderance of the evidence that Paragraph IV constituted a binding arbitration agree-

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[1] Citations are to the Appendix to the Petition ("App.") and to the record before the Ninth Circuit. (CR refers to the district court clerk's record and RT to the reporter's transcript.)

[2] The Petition states that Nicaragua requested discovery on the question whether the Memorandum was a binding contract. Petition at 6. In fact, Nicaragua consistently opposed any proceedings on this issue before the court, rather than the arbitrators. Only *after* Judge Vukasin ruled that he would hold a hearing on this issue did Nicaragua ask for an opportunity to conduct discovery.

[3] Indeed, his adoption of Petitioners' language was so complete that he copied their typographical errors.

ment covering the disputes at issue in the case. Conclusions of Law, ¶¶ 9-10.[4]

Nicaragua appealed Judge Vukasin's denial of its arbitration motion to the Ninth Circuit. Nicaragua argued (1) that the validity of the Memorandum of Intent was an issue that the district court should not have reached, because under the "separability" doctrine of *Prima Paint*, 388 U.S. at 403-07, the court was to have confined its role to determining the validity and scope of the arbitration clause; (2) that the district court's conclusion that the evidence did not demonstrate that the Memorandum was a binding contract was clearly erroneous; and (3) that the district court also erred in concluding that Paragraph IV of the Memorandum did not constitute a binding agreement to arbitrate the disputes before the court.

On July 1, 1991, the Court of Appeals, in a unanimous decision, reversed the judgment of the district court and remanded the case for an order directing arbitration. The Court held, first, that under *Prima Paint* the district court should have left it to the arbitrators to decide all questions other than the validity and scope of the arbitration clause. It further held that Paragraph IV must be construed as an enforceable arbitration agreement covering the disputes at issue in this case. The Court interpreted the language of Paragraph IV in light of the strong federal policy in favor of arbitration, especially in the context of an international dispute, and in light of the requirement

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[4] Judge Vukasin also granted Petitioners' motion for summary judgment on Count II. This ruling was reversed by the Court of Appeals, but Petitioners are not seeking review of that aspect of the Ninth Circuit's decision.

that any doubts about the scope of an arbitration agreement be resolved in favor of arbitration.

Petitioners subsequently filed a petition with the Ninth Circuit seeking rehearing or rehearing *en banc*, which was denied on October 17, 1991. The petition for a writ of certiorari followed.

B. Statement of Facts

Beginning in 1970, Petitioners controlled the production, quality and price of Nicaraguan bananas through their participation in partnerships with Nicaraguan landowners. CR 5 at 2; RT at 317. The partnerships were contractually obligated to sell their entire banana output to Petitioners at prices determined by Petitioners, who then exported the bananas to the United States and resold them here at higher prices. CR 6 at 3. However, when a new Nicaraguan government came to power in 1979, it entered into negotiations with Petitioners to work out a new contractual relationship that would maintain high productivity but produce greater benefits for the banana workers. RT at 13-14, 21, 76; Exs. A-19A through A-25A.

After a breakdown in these negotiations in December 1980, Petitioners announced the termination of their Nicaraguan operations and ceased their purchase of Nicaraguan bananas. RT at 274-75; CR 99, tab 3 at 46, 48-50. The Nicaraguan government, seeking to resolve the impasse and reach an agreement under which Petitioners would continue their operations, sent three high-level officials to San Francisco to meet with top executives of Petitioners. RT at 34, 190. Three days of negotiations ensued. RT at 34, 36; Ex. A-37. Petitioners presented a list of 18 demands, and agree-

ment on all of them was eventually reached after hard bargaining. RT at 38-39, 277; Exs. A-32, A-37 at 17-21.

On January 11, 1981, a document containing the final agreement on these points—drafted principally by Castle & Cooke's General Counsel (RT at 324)—was signed. The document, captioned "Memorandum of Intent," set forth the agreement reached by the parties on each of Petitioners' 18 points. App. at 49a; RT at 41-50. Among other things, it specified the price per box of bananas to be sold to Petitioners ($4.30 less specified deductions), the term (five years), the designation of the goods (all first quality bananas as determined by Petitioners) and the quantity (all acreage in the Nicaraguan banana program). The Memorandum called for the subsequent drafting of additional implementing contracts to spell out the details of the banana purchase and technical assistance aspects of the agreement, and the parties subsequently exchanged drafts of these agreements. However, many of the points agreed to by the parties were not subject to any additional implementing contracts, and the Memorandum itself set forth all of the essential terms of the banana purchase agreement between the parties. RT at 298-99.

In addition, the Memorandum contained an arbitration clause. Paragraph IV provided:

> **IV. Arbitration:**
>
> Any and all disputes arising under the arrangements contemplated hereunder, should same not be able to be settled amicably settled [sic] by the parties, will be referred to mutually agreed mechanisms or procedures of international arbitration,

> such as the rules of the London Arbitration Association.

The parties agreed to this clause to avoid having disputes decided in the home forum of either party. RT at 333; CR 99, tab 8 at 17, 55; *id.*, tab 3 at 150. Although, as it turned out, the "London Arbitration Association" was a misnomer, the fact that the parties settled on London as a neutral site for the arbitration is undisputed. RT at 56, 333, 367-68. Thus, shortly after the Memorandum of Intent was signed, Petitioners' General Counsel, Robert Moore, who drafted the provision, wrote to Nicaragua's counsel confirming that "what resulted [in San Francisco] was an agreement providing for arbitration." Ex. A-15. Seeking to correct the misnomer of the arbitral tribunal "in the infancy of the agreement," Mr. Moore proposed that the parties agree to a "substitute arbitration clause" that he enclosed with the letter. *Id.*

The Nicaraguan signers of the Memorandum testified that they, too, understood that an arbitration agreement had been signed, and that it required the arbitration of any dispute concerning any of the points covered by the Memorandum.[5] RT at 55, 200-01. Likewise, Nicaragua's former U.S. counsel, Norton Ten-

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[5] Petitioners assert incorrectly that the language of Paragraph IV was "diluted" by the Nicaraguans during the drafting process. Petition at 8. In fact, the key language of the paragraph—naming the situs as London, and stating that disputes "will be referred" to arbitration there—never changed. Moreover, the paragraph's coverage of "any and all disputes arising under the arrangements contemplated hereunder" clearly referred to disputes arising under any of the terms of the Memorandum itself, since "arrangements" is used that way elsewhere in the Memorandum (in the fourth paragraph of the preamble).

nille, who helped Mr. Moore draft the clause (and who had had no relationship with Nicaragua since 1981), testified that Paragraph IV was intended to mean that "any disputes which were going to arise in the course of business which was to be initiated with the conclusion of this memorandum would be subject to arbitration." CR 99, tab. 8 at 41-42.

Throughout the Memorandum, the undertakings of each party were expressed in obligatory language, and the document refers to itself as "this agreement." App. at 51a (Para. V). The Spanish version, which was prepared by Petitioners and was signed by all four officers of Petitioners who signed the English version, refers to itself as a "contract" ("contrato"). Ex. A-40 at Para. IX. All of the Nicaraguan signers of the Memorandum testified that they understood it to be a binding contract when they signed it. RT at 39, 202, 139-40. This included Arturo Cruz, who left the Nicaraguan government in 1981 and subsequently (prior to giving testimony in this case) joined the leadership of the armed opposition seeking to overthrow it. RT at 131-33. Mr. Tennille also testified that the parties understood the Memorandum of Intent to be binding. CR 99, tab 8 at 34, 47-49. Even Petitioners' witnesses testified that the Memorandum of Intent embodied "a meeting of the minds" on all essential elements of the purchase and sale of bananas. RT at 299.

Upon signature of the Memorandum, Petitioners repeatedly characterized it as a binding contractual agreement. In their press release announcing the Memorandum, they called it a "final agreement." Ex. A-2. In their next Annual Report, they called it a "five-year contract under which the Company will pur-

chase [Nicaragua's] banana production and concurrently recover its investment there." Ex. A-4. In their Form 10-K's filed with the Securities and Exchange Commission, they called it a "contract," a "five-year purchase contract for [Nicaragua's] banana production and purchase of the Company's assets," a "general agreement," and an "agreement." Ex. A-3 at 2; Ex. A-5 at 2; Ex. A-6 at 2. In numerous telexes and letters to third parties, Castle & Cooke's president called it an "agreement," a "final agreement," and a "mutually satisfactory agreement" that was reached "after extended deliberations and negotiations." *See, e.g.*, Ex. A-7A; Ex. A-9; Ex. A-10; Ex. A-11.

After the Memorandum was signed, the parties promptly began to comply with its terms. Within a week, Petitioners sent their employees back to Nicaragua and resumed their banana operations there. RT at 283-85, 288. In so doing, they incurred significant costs and risks, including the sacrifice of a potential insurance claim worth approximately $9 million. *Id.* at 310-11. For the next 22 months, they bought all of Nicaragua's export quality bananas (some seven million boxes) in accordance with the price and other terms set forth in the Memorandum of Intent. RT at 288, 185-86. The parties performed other obligations under the Memorandum as well; for example, Petitioners began transferring ownership of their physical assets to the Nicaraguan Government pursuant to Paragraph II. Ex. A-47A; Ex. A-48A; RT at 210-11; CR 99, tab 6 at 286-87.[6]

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[6] Thus, Petitioners' assertion that many "obstacles" remained to the consummation of a contractual arrangement is mistaken. Petition at 9. In reality, the essential terms had been agreed

However, on October 25, 1982, without prior warning, Petitioners permanently terminated their Nicaraguan operations. This lawsuit arose from that action.

REASONS FOR DENYING THE WRIT

Neither of the arguments offered in support of the Petition has merit. The first argument—that the Court of Appeals violated Rule 52 of the Federal Rules of Civil Procedure and "split" with other circuits by "reviewing *de novo* the district court's factual findings concerning the existence of a binding arbitration agreement" (Petition at 14)—rests on an erroneous characterization of what the Court of Appeals did. The Court of Appeals' opinion makes clear that what the Court reviewed *de novo* was not any findings of fact of the district court, but the language of the arbitration clause in the parties' Memorandum of Intent to determine the arbitrability of the dispute. And it is well settled throughout the circuits that determinations of arbitrability, like the interpretation of any contractual provision, are subject to *de novo* review.

Petitioners' second argument is equally flawed. They contend that the Court of Appeals erred in holding that the district court should have confined its role to consideration of the arbitrability of the dispute and

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upon (price, term, definition, quantity), and no obstacles to performance existed. For example, Petitioners suggest that a new "competent national entity" remained to be established by the Nicaraguan government. Petition at 10. But when the Memorandum was signed, an appropriate entity, called "BANANIC," already existed. BANANIC bought the fruit from the partnerships and sold it to Petitioners until mid-1981, when another entity called "EMBANOC" was set up—at which point both it and BANANIC participated in the sales from the partnerships to Petitioners. RT at 62-63, 120-21.

left to the arbitrators the question whether the Memorandum of Intent was a binding contract between the parties. But under *Prima Paint* that is exactly what the district court was required to do. Under the severability rule of *Prima Paint*, an arbitration agreement that covers the disputes at issue must be enforced even if the rest of the contract in which it is embedded may later be held invalid by an arbitration tribunal. Thus, the Court of Appeals' application of *Prima Paint* in this case was not "misplaced," Petition at 23, and there is no issue presented that calls for review by this Court.

I. THE COURT OF APPEALS CORRECTLY REVIEWED THE LANGUAGE OF THE ARBITRATION CLAUSE DE NOVO TO DETERMINE ARBITRABILITY

In their first argument for granting the writ, Petitioners seek review of something the Court of Appeals did not do. The Ninth Circuit did not review *de novo* any factual findings of the district court. Rather, the Court of Appeals did exactly what is within its province to do: it reviewed the language of an arbitration clause *de novo* to determine the arbitrability of the dispute presented, and then applied the well-settled legal presumption in favor of arbitration. Thus, the Court of Appeals did nothing constituting a "split with other circuits" or a violation of Rule 52 of the Federal Rules of Civil Procedure. Accordingly, Petitioners' first argument provides no basis for granting the writ.

Having decided (correctly—*see* Part II, *infra*) that under *Prima Paint* the only issue properly before the district court was arbitrability—*i.e.*, the validity and scope of the arbitration clause—the Court of Appeals focussed its attention on Paragraph IV of the Mem-

orandum, in the section entitled "Arbitration Agreement and Scope." 937 F.2d at 477-79. The Ninth Circuit's opinion makes clear on its face that its consideration of arbitrability was based on its interpretation of the language of Paragraph IV, and not on any "appellate fact-finding" (Petition at 15).

At the outset of this section of the opinion, the Court noted that the issue of arbitrability must be determined by "contractual interpretation"—*i.e.*, by analysis of the language of the arbitration clause. 937 F.2d at 477 (citations omitted). The Court then analyzed the language of Paragraph IV to determine whether an enforceable arbitration agreement existed, and if so whether its scope covered the disputes presented in this case. It concluded, first, that an enforceable agreement existed because the language of Paragraph IV was "not too vague to be given effect," particularly when considered in light of the "presumption of arbitrability established by the Supreme Court." *Id.* at 478. The Court then concluded—again based on the *language* of Paragraph IV—that the phrase "any and all disputes arising under the arrangements contemplated hereunder" must be construed to encompass the claims presented in this case, under the applicable legal standard requiring enforcement of an arbitration clause if the "purported agreement . . . is susceptible of an interpretation" that would allow arbitration. *Id.* at 479 (citations omitted). Thus, the Court stated its ultimate holding as follows:

> We hold that *the language of the clause at issue here*, read in light of the *Prima Paint* severability rule and the strong presumption of arbitrability in international disputes, requires that the arbitration clause be enforced . . . .

Id. at 479-80 (emphasis added).[7]

Clearly, then, what the Court of Appeals reviewed *de novo* was the arbitrability of the dispute, based on the language of the arbitration clause. That was entirely proper. First, it is beyond dispute that, as the Ninth Circuit noted, the interpretation of contract language is a question of law to be reviewed *de novo*. 937 F.2d at 474 (citing *United States v. City of Twin Falls*, 806 F.2d 862, 869 (9th Cir. 1986), *cert. denied*, 482 U.S. 914 (1987)). *Accord United States v. Liranzo*, 944 F.2d 73, 77 (2d Cir. 1991); *Step-Saver Data Sys., Inc. v. Wyse Technology*, 939 F.2d 91, 97 & n.8 (3d Cir. 1991); *Network Publishing Corp. v. Shapiro*, 895 F.2d 97, 99 (2d Cir. 1990)("[A]ppellate courts have untrammelled power to interpret written documents" (quoting L. Hand, J.) (citation omitted)); *First Nat'l Bank of Miami v. Ins. Co. of N. Am.*, 495 F.2d 519, 522 (5th Cir. 1974) (citing authorities in several circuits for the "virtually unanimous acceptance of the

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[7] The Court of Appeals also noted that the district court had considered evidentiary factors that were irrelevant as a matter of law, and had failed to consider substantial documentary evidence, including the letter written just after execution of the Memorandum by the principal draftsman of Paragraph IV, Castle & Cooke Counsel Robert Moore, referring to Paragraph IV as "an agreement providing for arbitration." 937 F.2d at 479. *See id.* at 473. These dicta plainly do not constitute *de novo* review of any findings of fact of the district court. Nor did the Court of Appeals second-guess any determination by the district court as to the credibility of testimony concerning the validity or scope of the arbitration clause, as Petitioners argue. Finding of Fact, ¶ 57, cited by Petitioners, related to testimony concerning the validity of the Memorandum *as a whole*—an issue the Court of Appeals correctly held never should have been reached by the district court. *See* Part II *infra*.

proposition that the interpretation of a contract is a question of law, not fact, and, therefore, not restricted to review under the 'clearly erroneous' rule").

It is also well settled that this rule is fully applicable in the context of the Federal Arbitration Act. Thus, as the Court of Appeals noted, "[d]eterminations of arbitrability, like the interpretation of any contractual provision, are subject to *de novo* review." 937 F.2d at 474 (citations omitted). This rule is by no means unique to the Ninth Circuit[8]; on contrary, it is widely accepted. *See, e.g., Storey v. Shearson Lehman Hutton, Inc.*, 949 F.2d 1039, 1040 (8th Cir. 1991) (decisions regarding the validity and scope of arbitration clauses are reviewed *de novo*); *Shearson Lehman Hutton, Inc. v. Wagoner*, 944 F.2d 114, 121 (2d Cir. 1991) (determination of scope of arbitration agreement reviewed *de novo*); *Neal v. Hardee's Food Sys., Inc.*, 918 F.2d 34, 37 (5th Cir. 1990) (same), *reh'g denied* (Dec. 26, 1990)(Westlaw, Allfeds database); *Kansas Gas & Elec. Co. v. Westinghouse Elec. Corp.*, 861 F.2d 420, 422-23 (4th Cir. 1988) (determination of whether arbitration clause had been "triggered" subject to *de novo* review); *Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 846 (2d Cir. 1987)(determination of scope reviewed *de novo*); *McGinnis v. E.F. Hutton & Co.*, 812 F.2d 1011, 1012-13 (6th Cir.) (same), *cert. denied*, 484 U.S. 824 (1987). Thus, the Court of Appeals' review *de novo* of the validity and scope of Paragraph

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[8] In the Ninth Circuit, the authorities include *First Investors Corp. v. Am. Capital Fin. Servs., Inc.*, 823 F.2d 307, 309 (9th Cir. 1987); *Bauhinia Corp. v. China Nat'l Mach. & Equip. Import & Export Corp.*, 819 F.2d 247, 249 (9th Cir. 1987); *Mediterranean Enters., Inc. v. Ssangyong Corp.*, 708 F.2d 1458, 1462-63 (9th Cir. 1983).

IV of the Memorandum of Intent could hardly be considered to have created a "split with other circuits." Petition at 14.[9]

Nor did the Court of Appeals stray from its proper role in applying the correct legal principles governing the interpretation of arbitration agreements under the Federal Arbitration Act, without regard for the erroneous legal standard adopted by the district court. The district court mistakenly thought the test was whether Nicaragua had "establish[ed] by a preponderance of the evidence that the disputes before the court must be arbitrated." Conclusions of Law, ¶ 10; *see also* Findings of Fact, ¶ 68. That is directly contrary to the presumption this Court has established in favor of arbitration, particularly in the context of an international transaction like this one.[10] It is also inconsistent with the proper test of the scope of an

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[9] The only case cited by Petitioners as purportedly representing such a "split" is *Interocean Shipping Co. v. National Shipping & Trading Corp.*, 523 F.2d 527 (2d Cir. 1975), *cert. denied*, 423 U.S. 1054 (1976). In *Interocean*, however, the district court findings that were upheld by the Second Circuit under the clearly erroneous standard involved *not* the validity or scope of the arbitration clause, but the question whether the parties had reached agreement on anything at all. In that case, the parties did not sign the charter party at issue; they were still exchanging telexes when the negotiations broke down. Here, by contrast, it is not disputed that the parties reached agreement on the Memorandum containing the arbitration clause. Thus, in this case, where arbitrability issues were presented, it was appropriate for the Court of Appeals to review them *de novo*.

[10] *See, e.g., Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625-26 (1985); *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24-25 (1983); *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511, *reh'g denied*, 419 U.S. 885 (1974).

arbitration clause—requiring that arbitration be compelled "unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute," and that any doubts be resolved in favor of arbitration.[11] Petitioners do not and cannot dispute that these well-established legal principles are fully apposite here, and that the Court of Appeals was entitled—indeed, required—to apply them, *de novo*.

In short, the Ninth Circuit performed precisely the role that it was supposed to perform. It engaged in its own interpretation of the language of the arbitration clause, and applied the correct principles of law under the Federal Arbitration Act. In doing so, it rendered a decision that is not in conflict with the decisions of other Courts of Appeals, a departure from the accepted and usual course of judicial proceedings, or otherwise appropriate for review by this Court. Supreme Court Rule 10.

II. THE COURT OF APPEALS CORRECTLY HELD THAT UNDER *PRIMA PAINT* THE DISTRICT COURT ERRED IN FAILING TO LIMIT ITS ROLE TO DETERMINING WHETHER THE DISPUTE IS ARBITRABLE

As the Court of Appeals below recognized, the only issue properly before the district court was a narrow one: did the parties agree in writing to refer to international arbitration the disputes presented in this

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[11] *United Steelworkers of Am. v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582-83 (1960). *See also, e.g., Moses H. Cone*, 460 U.S. at 24-25; *David L. Threlkeld & Co., Inc. v. Metallgesellschaft Ltd. (London)*, 923 F.2d 245, 250 (2d Cir.), *cert. dismissed*, 112 S.Ct. 17 (1991); *Neal v. Hardee's*, 918 F.2d at 37; *Howard Elec. & Mech. Co. v. Frank Briscoe Co.*, 754 F.2d 847, 850 (9th Cir. 1985).

case? If so, the Federal Arbitration Act required referral of the case to arbitration, including all issues relating to the proper interpretation of the Memorandum of Intent. As shown below, the district court's contrary holding, that it was required to determine the validity of the Memorandum of Intent before referring this case to arbitration (Conclusions of Law, ¶¶ 2-3), was simply wrong as a matter of law.

The Federal Arbitration Act establishes a federal substantive law of arbitration that carefully restricts the courts' discretion over agreements to arbitrate. The overriding purpose of the Act is to further the strong federal policy in favor of arbitration. Thus "Congress' clear intent, in the Arbitration Act, [was] to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone*, 460 U.S. at 22. *See also Mitsubishi*, 473 U.S. at 625-26 (" '[t]he preeminent concern of Congress in passing the Act was to enforce private agreements into which parties had entered,' a concern which 'requires that we rigorously enforce agreements to arbitrate' ") (citation omitted).

The Act thus limits the purview of the courts to "the making of the arbitration agreement" itself. 9 U.S.C. § 4. If the parties have agreed in writing to arbitrate their disputes, and there has been a failure by one party to honor that agreement, "the Act leaves no place for the exercise of discretion by a district court, but instead mandates that district courts *shall* direct the parties to proceed to arbitration on issues as to which an arbitration agreement has been signed." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 218 (1985) (emphasis in original).

Thus, as this Court has held, all challenges to the validity or enforceability of the entire contract, as opposed to the arbitration clause within it, are for the arbitrators, not the courts, to resolve. *Prima Paint*, 388 U.S. at 402-04.

Petitioners urge this Court to review the decision below on the theory that the Ninth Circuit has "stretched" this Court's holding in *Prima Paint*. In fact, however, the Court of Appeals scrupulously followed the dictates of *Prima Paint* by refusing to permit the district court to substitute its judgment as to the validity of the Memorandum of Intent for that of the arbitrators. In so holding, the Ninth Circuit followed *Prima Paint* (and the consistent decisions of other Circuits on this issue) to the letter.

Petitioners' argument, by contrast, is nothing less than a *sub rosa* request for this Court to reverse *Prima Paint*. Without saying so expressly, Petitioners have simply taken the position of the dissent in *Prima Paint*, and urged this Court to adopt that position, contrary to settled precedent, the federal policy favoring arbitration, and the language of the Federal Arbitration Act. But there is simply no good reason for this Court to reverse its prior holdings.

In *Prima Paint*, the issue was whether a claim of invalidity of the contract as a whole should be resolved by the arbitrators or by the court. The party opposing arbitration argued that there had been fraud in the inducement of the contract as a whole, and that, since the contract was invalid, the arbitration clause contained within the contract was also necessarily invalid. The Supreme Court rejected that argument. It held that Section 4 of the Federal Arbitration Act did not permit the court to consider the validity of the entire

contract; it could only hear evidence relating to fraud in the inducement of the arbitration clause, since that alone related to the making of an agreement to arbitrate. 388 U.S. at 403-04. This principle was reaffirmed in *Moses H. Cone*, 460 U.S. at 24-25.

The decision in *Prima Paint* is universally recognized as establishing that arbitration provisions constitute "severable" contracts independent of the contracts in which they appear, and that while courts may consider challenges directed to the arbitration clause, they may not consider any challenges directed to the contract as a whole.[12] As Judge Posner explained for a unanimous panel of the Seventh Circuit:

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[12] The severability doctrine is accepted not only in the United States, but in virtually all of the major industrialized countries as well. For example, Article 178(3) of the Swiss Private International Law Act provides that "the validity of an arbitration agreement cannot be contested on the ground that the main contract may not be valid." Similarly, Article 1053 of the Code of Civil Procedure of the Netherlands provides that "an arbitration agreement shall be considered and decided upon as a separate agreement. The arbitration tribunal shall have the power to decide on the validity of the contract of which the arbitration agreement forms part or to which the arbitration agreement is related." *See also, e.g.*, Judgment of March 16, 1977, Landgericht, Hamburg (Germany) (ordinary court of first instance), *summarized in* III Y.B. Comm. Arb. 274 (1978); Judgment of July 15, 1975, Saikosai (Supreme Court), Japan, 29 Minshu 1061, *summarized in* Doi, *National Report: Japan*, IV Y.B. Comm. Arb. 115, 122 (1979). Moreover, because the severability presumption is so widespread, the major arbitration institutions have incorporated it into their rules. *See, e.g.*, Article 8(4) of the ICC Rules of Conciliation and Arbitration ("The arbitrator shall not cease to have jurisdiction by reason of any claim that the contract is null and void or allegation that it is non-existent provided that he upholds the agreement to arbitrate").

> 1. If a court had to resolve a challenge to the validity of the entire contract before the arbitration could begin, the arbitrator, though the parties' designated arbiter of disputes under the contract, would have much less scope for decision than a judicial arbiter of contract disputes.
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> 2. An arbitration clause will often be "severable" from the contract in which it is embedded, in the sense that it may be valid even if the rest of the contract is invalid. If the agreement of one party to arbitrate disputes is fully supported by the other party's agreement to do likewise, there is no need to look elsewhere in the contract for consideration for the agreement to arbitrate; so objections to other parts of the contract, based on fraud or unconscionability or mistake or whatever, need not spill over to the arbitration clause.

Matterhorn, Inc. v. NCR Corp., 763 F.2d 866, 868-69 (7th Cir. 1985) (citations omitted). *See also, e.g., Howard Elec.*, 754 F.2d at 850 ("The merits of the claim and any defenses are for the arbitrator to evaluate, not the courts"); *Muh v. Newberger, Loeb & Co., Inc.*, 540 F.2d 970, 972 (9th Cir. 1976) (if parties have agreed to arbitrate, "the entire controversy must be referred to the arbitrator, including the validity of the contract").

Notwithstanding the severability doctrine, the district court in this case ruled that it had to decide whether the Memorandum of Intent was a binding contract before it could refer this case to arbitration. But that is exactly the position rejected by the

Supreme Court in *Prima Paint*. Accordingly, the Ninth Circuit correctly reversed the district court, and held that, in keeping with *Prima Paint*, Petitioners' challenge to the validity of the Memorandum of Intent had to be referred to the arbitrators.

Petitioners argue, first, that the Ninth Circuit erred in applying the *Prima Paint* rule to this case because the language of the arbitration clause and of the Memorandum of Intent as a whole is, in Petitioners' view, "highly ambiguous." However, Petitioners' suggestion that the *Prima Paint* rule applies only if the arbitration clause at issue is "on its face, clearly and unequivocally intended as binding" (Petition at 24) turns on its head settled law governing the interpretation of arbitration agreements. As the Ninth Circuit correctly held below, and as this Court has held on many occasions, the federal policies favoring arbitration mandate that arbitration provisions must be generously construed. *See supra* at 15-16. Applying this presumption of arbitrability, the Ninth Circuit correctly concluded that Paragraph IV of the Memorandum of Intent, which provided that all disputes under the Memorandum "will be referred to arbitration," constituted an enforceable arbitration agreement. Reading Paragraph IV *de novo*, the Court of Appeals found that it was neither too ambiguous nor too vague. Having reached that conclusion, the Ninth Circuit had no legal basis for considering or resolving any ambiguities in the Memorandum as a whole. To the contrary, under the *Prima Paint* doctrine, and under Section 4 of the Act, the Court of Appeals had no choice but to refer Petitioners' attacks upon the Memorandum as a whole to arbitration.

Petitioners' second basis for attacking the Ninth Circuit's opinion is in reality an attack on *Prima Paint* itself. Petitioners contend that the Ninth Circuit erred in refusing to permit the district court to decide Petitioners' claim that the Memorandum of Intent as a whole was unenforceable because the parties did not intend to be bound by its terms when they signed it. According to Petitioners, the district court was required to determine the validity of the Memorandum, because in Petitioners' view, if the Memorandum was not a contract, then "there was no mutual promise to arbitrate because there was no mutual promise at all." Petition at 25.

But this is precisely the argument the majority in *Prima Paint* rejected. In asserting its fraud claim, Prima argued—just as Petitioners argue here—that there could be no agreement to arbitrate because "there was never a meeting of the minds between the parties" on the underlying contract. 388 U.S. at 408 (Black, J., dissenting). The question presented was thus whether it is for the court or the arbitrators to decide "the legal question of *whether any legal contract exists* upon which to base an arbitration." *Id.* (emphasis added). The dissenters—like Petitioners here—would have held that because "there is absolutely no contract" there was "nothing to be arbitrated." *Id.* at 412. The majority in *Prima Paint* refused to accept this argument, and held that all challenges to the validity of the contract as a whole are for the arbitrators to decide.

Petitioners' suggestion that *Prima Paint* applies when the underlying agreement is alleged to be void for lack of consideration, unconscionability, or vagueness, but does not apply when the ground for chal-

lenging the validity of the contract is that the parties did not intend to be bound by it, simply cannot withstand analysis. The gravamen of the dissent in *Prima Paint* was precisely that the fraud alleged in that case, if proven, would vitiate the consent of Prima to the entire contract, and render all of its terms null and void. As the dissenting Justices put it, "Prima would not have agreed to the covenant not to compete or to the arbitration clause but for F & C's fraudulent promise that it would be financially able to perform consulting services." *Prima Paint*, 388 U.S. at 424 (Black, J., dissenting). Accordingly, it is futile to argue that in *Prima Paint* "the parties intended their contract to be binding at the time they signed it." Petition at 24. As the dissenters in *Prima Paint* pointed out, if Prima's allegations of fraud were true, then Prima's assent to the contract that was signed was meaningless.

The majority in *Prima Paint* did not dispute the dissent's analysis of the potential effect of Prima's claims. But it did find that the Federal Arbitration Act nonetheless required referral to arbitration of all challenges to the agreement as a whole. Thus, there is no principled basis for distinguishing between this case and *Prima Paint*. In each case, the party opposing arbitration argued that its consent to the agreement as a whole, and therefore its consent to the arbitration clause at issue, was invalid. In each case, the party opposing arbitration argued that it was for the court to decide "whether any legal contract exists." *Prima Paint*, 388 U.S. at 408 (Black, J., dissenting). This Court properly rejected that argument in *Prima Paint*, and the Ninth Circuit properly rejected it in this case.

Other courts to consider the issue in circumstances analogous to the present case have reached the same conclusion. For example, in *Sauer-Getriebe KG v. White Hydraulics, Inc.*, 715 F.2d 348, 350 (7th Cir. 1983), *cert. denied*, 464 U.S. 1070 (1984), the Seventh Circuit held that "there is nothing that requires that courts rather than arbitrators decide the validity of contracts. . . ." It therefore rejected an argument much like that made by Petitioners here:

> White claims that before this dispute may be submitted to arbitration, a court must decide that the contract containing the arbitration clause is valid and enforceable. White argues that if there is no contract to buy and sell motors there is no agreement to arbitrate. The conclusion does not follow its premise. The agreement to arbitrate and the agreement to buy and sell motors are separate. Sauer's promise to arbitrate was given in exchange for White's promise to arbitrate and each promise was sufficient consideration for the other.

Id. (citation omitted). *See also Flender Corp. v. Techna-Quip Co.*, Nos. 89-2781, 89-3045, 91-1268 (7th Cir. Jan. 6, 1992)(Westlaw, Allfeds database) (claim that agreement containing arbitration clause had terminated prior to dispute was for arbitrator to decide, since "the [severability] principle is applicable even when the underlying dispute involves the validity of the entire contract").

The Fifth Circuit reached a similar conclusion in *Merrill Lynch, Pierce, Fenner, & Smith, Inc. v. Haydu*, 637 F.2d 391 (5th Cir. 1981). There, the plaintiff asked

the court to rule on her argument that the contract requiring arbitration was obtained "under circumstances of coercion, confusion, undue influence, and duress." 637 F.2d at 398 n.11. The Court of Appeals held that such claims were for the arbitrator to decide, "since they go to the formation of the entire contract rather than to the issue of misrepresentation in the signing of the arbitration agreement." *Id.* at 398. *Accord Shotto v. Laub*, 632 F. Supp. 516, 520-21 (D. Md. 1986) (arbitrator, not court, should decide plaintiffs' claim that the agreements at issue were not in existence at the time the claims arose).

The First Circuit, too, has rejected the argument that an arbitration clause should not be enforced prior to resolution of the defendant's claim that the entire contract was nonexistent or unenforceable:

> The teaching of *Prima Paint* is that a federal court must not remove from the arbitrators consideration of a substantive challenge to a contract unless there has been an independent challenge to the making of the arbitration clause itself.

Unionmutual Stock Life Ins. Co. of America v. Beneficial Life Ins. Co., 774 F.2d 524, 529 (1st Cir. 1985).

Similarly, in *Mesa Operating Ltd. Partnership v. Louisiana Intrastate Gas Corp.*, 797 F.2d 238, 244 (5th Cir. 1986), the defendant opposed arbitration on the ground that the failure to obtain certain necessary state approvals "made the contract between LIG and Mesa void as never having been entered into." The Fifth Circuit rejected this argument, noting that because "LIG has not argued that the agreement to arbitrate is invalid separately from the entire contract

. . . the arbitration provision remains separate and enforceable under *Prima Paint.*" *Id. See also C.B.S. Employees Fed. Credit Union v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 912 F.2d 1563, 1567 (6th Cir. 1990) ("The *Prima Paint* doctrine is not limited, however, to rescission based on fraudulent inducement, but extends to all challenges to the making of a contract")(quoting *Rhoades v. Powell*, 644 F. Supp. 645, 653 (E.D. Cal. 1986)); *Miller v. Drexel Burnham Lambert, Inc.*, 791 F.2d 850, 854 (11th Cir. 1986) ("[a]llegations of unconscionability in the contract as a whole" are for the arbitrators to resolve); *Parris v. Dean Witter Reynolds, Inc.*, 659 F. Supp. 928, 930 (N.D. Ga. 1987) (if "plaintiff challenges the making of the entire contract as opposed to the arbitration clause itself, the determination of whether the contract, and therefore the arbitration agreement, is valid is for the arbitrator")(citation omitted).

Petitioners' suggestion that the circuit courts have split on this issue is simply incorrect. All of the cases relied on by Petitioners to support its notion that courts rather than arbitrators must decide the "threshold issue" of the validity of contracts containing arbitration clauses deal with a separate and distinct issue: the question of whether the parties ever assented at all to the agreement or document containing the arbitration provision at issue. For example, in *Three Valleys Municipal Water District v. E.F. Hutton & Co.*, 925 F.2d 1136, 1142 (9th Cir. 1991), which Petitioners quote out of context, a split panel of the Ninth Circuit held that when a party denies that it ever entered into the agreement containing the arbitration clause at issue, the district court must resolve that question before referring the dispute to

arbitration. The issue arose in *Three Valleys* because plaintiffs alleged that the individual who signed the client agreements at issue lacked the authority to do so. In such a case, the question is not whether the document the parties executed is binding, but whether the parties ever executed anything at all.

Thus, in another Ninth Circuit decision, *Teledyne, Inc. v. Kone Corp.*, 892 F.2d 1404, 1410 (9th Cir. 1990), the Ninth Circuit rejected an argument identical to that of Petitioners here:

> The federal courts . . . requir[e] that cases be submitted to arbitration unless there is a challenge to the arbitration provision which is *separate* and *distinct* from any challenge to the underlying contract. "The teaching of *Prima Paint* is that a federal court must not remove from the arbitrators consideration of a substantive challenge to a contract unless there has been an independent challenge to the making of the arbitration clause itself."
>
> Kone has argued that the 1986 Draft was never finalized. It has attacked the contract as a whole without making an "independent challenge" to the arbitration provision. It has thus not waived its right to have an *arbitrator* determine whether the 1986 Draft was finalized.

Id. at 1410 (citations omitted)(emphasis in the original), *quoted in Three Valleys*, 925 F.2d at 1146 (Hall, J., dissenting). As the Ninth Circuit put it in this case, "where the parties admit to signing a document that contains an arbitration provision, as here and in *Teledyne*, all questions regarding breach of the agree-

ment must be referred to arbitration." 937 F.2d at 477.

The other cases relied on by Petitioners are much like *Three Valleys*. In *Par-Knit Mills, Inc. v. Stockbridge Fabrics Co.*, 636 F.2d 51 (3d Cir. 1980), appellants argued that the individual executing the contracts at issue lacked the authority to bind the corporation. Similarly, in *I.S. Joseph Co. v. Michigan Sugar Co.*, 803 F.2d 396 (8th Cir. 1986), the question was whether a party that agreed to arbitrate with another party could be forced into arbitration with an assignee of that other party.[13] This case would be comparable to those cases only if Petitioners could deny that they had entered into the Memorandum of Intent at all.[14] Since Petitioners admit to having entered into the Memorandum of Intent, and since the Memorandum on its face contains an arbitration clause that is severable from the Memorandum itself, the

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[13] Petitioners also cite *Pollux Marine Agencies, Inc. v. Louis Dreyfus Corp.*, 455 F. Supp. 211, 219 (S.D.N.Y. 1978). In that case, the court concluded that it had to consider the parties' challenge to the validity of the charter agreement at issue only because the language of the arbitration clause itself "necessarily implie[d] that the existence of the charter is not a question for arbitration." As the Ninth Circuit noted below, there is no basis for reading the arbitration clause at issue in this case as excluding challenges to the validity of the Memorandum of Intent from the consideration of the arbitrators.

[14] In fact, that is exactly what Standard Fruit Company does contend. It argues that it did not sign the Memorandum of Intent, and that neither Standard Fruit & Steamship nor Castle & Cooke signed on its behalf. Accordingly, the Ninth Circuit, in keeping with *Three Valleys*, held that this question, as distinct from Petitioners' overall challenge to the Memorandum of Intent, must be decided by the district court. 937 F.2d at 480-81.

Court of Appeals was entirely correct and fully consistent with the decisions of this Court and others in directing that the parties' dispute be referred to arbitration.[15]

Petitioners' final argument is that the decision of the Court of Appeals is inconsistent with federal policy, because it will discourage "pre-contractual discussions about the possibility of arbitration. . . ." Petition at 27. In fact, of course, the Ninth Circuit's decision, which simply follows *Prima Paint*, will have no such effect. To avoid arbitration under the Ninth Circuit's decision, a party need only refrain from signing an arbitration agreement.

Petitioners in this case signed an arbitration agreement, which they now wish to avoid. But federal policy requires that they be held to the terms of the arbitration provision they signed. As this Court correctly held in *Prima Paint*, the overriding purpose of the Federal Arbitration Act is to further the strong federal policy in favor of arbitration. The Ninth Circuit's decision to send this case to arbitration clearly

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[15] Petitioners' hypothetical, a preliminary agreement that expressly states that all of its terms are non-binding, is easily answered. As the Ninth Circuit expressly stated below, courts reviewing documents such as the Memorandum of Intent "must first make a threshold finding that the document at least purports to be" a contract. 937 F.2d at 476 (citations omitted). So long as the Memorandum is susceptible of such an interpretation, and so long as the arbitration clause in it may be interpreted broadly enough to cover claims relating to the validity of the Memorandum as a whole, such claims must be referred to arbitration. If the document at issue cannot be construed as an agreement, as in Petitioners' hypothetical, then under the Ninth Circuit's ruling, disputes relating to that document need not be sent to arbitration.

furthers that federal policy. By contrast, if this Court were to adopt Petitioners' proposed revisions to existing law, it would encourage parties to resort to litigation whenever they wished to avoid arbitration, and permit them to do so simply by alleging that they did not intend to be bound by the arbitration provision they signed. Such a rule would plainly subvert Congress' clearly expressed desire to hold parties to their agreements to arbitrate, and to have parties sent to arbitration without the costs and delays of collateral litigation.

CONCLUSION

The decision of the Court of Appeals was correct and raises no issues that merit review by this Court. Accordingly, the petition for a writ of certiorari should be denied.

Dated: February 14, 1992 Respectfully submitted,

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